

**STATEMENT BEFORE THE HOUSE BANKING AND
FINANCIAL SERVICES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND
CONSUMER CREDIT
SUBCOMMITTEE ON HOUSING AND COMMUNITY
OPPORTUNITY**

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BY

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Subcommittee on Financial Institutions and Consumer Credit
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Thank you Chairwoman Roukema and Chairman Lazio for the opportunity to testify today before this joint hearing of your respective Subcommittees. I join Governor Gramlich of the Board of Governors of the Federal Reserve System in reporting to you regarding the efforts of HUD and the Board to recommend reform of the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA).

The joint report on RESPA/TILA reform that Governor Gramlich discussed represents an unprecedented cooperative effort between HUD and the Board. We at HUD believe it carefully identifies problems under the current RESPA and TILA statutes, explores alternative solutions, and then offers substantial recommendations for legislative change. We are particularly grateful for the Board's dedication to the development of the report and the fine cooperation between our respective staffs in that effort. The interplay between these two staffs and the advice from outside interested parties, such as the Mortgage Reform Working Group, have given this report a vitality which it would not otherwise have achieved. I also want to personally commend the staffs of your subcommittees who have been most attentive and helpful in

their dealings with both agencies.

I. Improvements in the Current System

As Governor Gramlich indicated, the proposals in our joint Report would solve several problems under RESPA and TILA, to protect consumers and to provide clearer, less burdensome rules for industry. If enacted into law, these proposals would:

- Enable consumers to be better able to shop for home mortgages, increasing competition among settlement service providers to lower settlement costs;
- Provide lenders and other settlement service providers the choice of operating in a simplified and less restrictive regulatory framework, or to continue to operate in the current environment with clearer and more enforceable rules;
- Include new protections against predatory and abusive lending practices that have threatened the homes and the financial stability of many vulnerable homeowners nation-wide.

II. RESPA Reform

All of us recognize that buying and financing a home is a

consumer's largest and most complex financial transaction. For most new homeowners, the process is especially difficult and frustrating. Some new homebuyers may be the first in their families to own their own homes. Some new homebuyers have come from countries where owning their own home was beyond their expectations or experience. Most new homebuyers come away from the experience wondering whether they did the best they could, or whether the fees they paid were excessive.

Completing the homebuying process does not necessarily end the homebuyer's involvement with the home finance system. With the increase in real estate values and the down trend in interest rates, homeowners often refinance or take on additional secured debt. Even if they don't, they hear and see enticements to do so in the media every day.

New products have proliferated in the mortgage finance market to put homeownership within the reach of more Americans than ever before, allowing current homeowners to take advantage of the equity in their homes for home improvements and cash for cars or college, a needed medical service, or even to provide a stream of income for the retirement years. But with these opportunities have come some opportunists--predators who seek out unsophisticated or vulnerable homeowners to prey on for their own advantage, not to help. Older homeowners and homeowners who live in areas that are not well served by lenders may be particularly

confused and vulnerable to abusive practices.

We at HUD and my colleagues at the Federal Reserve Board believe that under RESPA and TILA, we must make the experience of buying and financing a home both simpler and, consistent with the purposes of these Acts, more efficient. Therefore, when Congress asked that the Board and HUD improve and simplify disclosures, we took our work seriously. In dealing with RESPA and TILA reform, we must address the needs of all types of consumers, those who are credit-savvy and those who are not; those who have strong credit records and those who do not. We must recognize the desirability of the free flow of credit, but we cannot be blind to the reality that the unwary consumer can be greatly harmed.

RESPA has dealt with some of the abuses that existed when the act was first passed, but it has not prevented other abuses from appearing. Legislative reform must deal not only with simplification for the benefit of lenders, but protection for the benefit of consumers. In this report, we at HUD have attempted to balance these competing interests, the needs of borrowers for a simpler and more efficient system and the creditors' need to assure security for the credit they extend. In most cases, the Board of Governors and HUD were able to make joint recommendations. In some circumstances, we deferred to the Board in respect for their expertise; similarly, in other areas, they deferred to us. On occasion, one or the other of us is submitting

our separate recommendations. But I want to assure the Congress that the process, which you mandated, involved an extensive consideration of all of the public and private views that both HUD and the Board could obtain, and an intense and interactive exchange of views between the Board and HUD on all of these critical issues.

From all of these interactions it has become clear to us that reform will not be possible without consensus on reform's major elements. Those who loan the money, those who provide the settlement services, those who service the loans, and those who insure the transaction if the loan somehow fails, all are parties affected by whatever rules the agencies make or the Congress enacts, and their interests have been well represented. The interests of consumers will be affected most of all; HUD and the Board took steps to ensure that their interests also have been well represented. We have seen evidence that the concerned parties are listening and learning from one another. Nonetheless, consensus has not yet been reached. It is the hope of HUD that this report will inspire consensus and will provide the necessary momentum for Congress, in cooperation with all the interested parties, to finish the job of mortgage reform.

III. Secretary Cuomo's Principles Concerning RESPA Regulations and Reform

At HUD, Secretary Cuomo established guiding principles for the Department's regulatory efforts under RESPA. These principles include:

- Assuring meaningful and timely disclosures to consumers;
- Protecting against illegal fees;
- Recognizing that the settlement industry is changing;
- Encouraging innovative products;
- Removing impediments to lending to underserved areas and borrowers;
- Involving consumer and mortgage industry groups; and
- Providing clear rules for affected industries and consumers.

HUD shaped its proposals in accordance with these principles.

IV. TWO HUD CONCERNS

Governor Gramlich deferred to me in two areas that I would like to cover now: the desirability of achieving reliable closing cost information in order to promote shopping and competition and the recommendations regarding predatory lending practices, including revisions of the Home Ownership Equity Protection Act (HOEPA).

A. Improved disclosure requirements and guaranteed costs.

Under current RESPA requirements, when a consumer shops for a mortgage loan, he or she frequently contacts one or more lenders or mortgage brokers. While many consumers will shop for more favorable loan terms, most do not comparison shop for the many settlement services. When the consumer visits a lender and sits down to discuss loan options, under current law the lender is not required to provide the consumer an estimate of settlement costs until after the consumer applies for the loan. Under RESPA, the consumer need not receive an estimate of settlement costs (the Good Faith Estimate or GFE) until the time of, or within a 3-day period after, loan application. The lender is not required to provide it by mail until three business days after application. This means that the borrower may not receive the GFE until a week after application.

And under RESPA, the estimate of settlement costs or GFE is

just that, an estimate. If consumers discover that the cost estimates they receive differ significantly from the final figures, they have no Federal remedies to address inaccuracies. Consumers also frequently must pay a fee before receiving the GFE, and they may receive it too late to find it helpful in comparison shopping.

While Section 8 of RESPA restricts kickbacks and unearned fees to protect consumers and reduce settlement costs, mortgage lenders and others say that it has adverse consequences to consumers. They say that Section 8's prohibitions make lenders and others unwilling to engage in activities to negotiate a package of settlement services and that this ultimately deprives the consumer of lower settlement costs. Consumers and industry groups say packaging could lead to more consumer shopping and price competition. Limited relief from RESPA's Section 8 prohibitions is therefore necessary to foster these arrangements.

Section 8 also has been used in litigation to protect consumers. Therefore, any changes to Section 8 to facilitate better disclosures necessitates substitute consumer protections. Also, in enacting HOEPA, the Congress was concerned that home equity-rich and cash-poor consumers were particularly vulnerable to being convinced to enter into mortgage loans that are not in the consumer's interest but would enrich the vendor, and worse, could lead to the loss of the consumer's home. These abuses

persist.

The detailed disclosures under RESPA, while welcomed by some borrowers, are daunting to others. Under TILA, consumers also frequently receive disclosure of the Annual Percentage Rate, or APR, and finance charges too late to allow consumers to shop for loans. The APR itself, because it is not widely understood and does not include all costs of obtaining a loan, is not an effective shopping tool for most consumers.

In order to solve these problems, HUD and the Board have recommended in the report that:

1. Creditors and others be required to give firmer disclosures of settlement costs to consumers to promote shopping, competition and lowered settlement costs. Both agencies recommend that creditors and others be offered a choice between guaranteeing settlement costs (so that the costs stay the same from the time they are disclosed through the time of settlement) or providing a firmer estimate to consumers (within a tolerance). Creditors and others would be liable for noncompliance.

To encourage cost guarantees, HUD recommends, and the Board supports, establishment of an exemption from Section 8 of RESPA be offered to creditors and other entities offering

a package of settlement services. HUD specifically recommends an exemption that meets appropriate conditions, including: (1) offering consumers a comprehensive package of settlement services needed to close a loan; (2) providing consumers with a simple prescribed disclosure that gives a guaranteed maximum price for the package of services through settlement; and (3) discloses the rate and points for the loan, and guarantees that the rate and points will not increase, subject to prescribed conditions.

HUD believes that consumers need complete information on rates and points and other closing costs as soon as possible. The Board recommends that initial disclosures be coordinated and provided within 3 days of application. This is the current RESPA rule, but not the TILA rule.

HUD recommends earlier initial disclosures and believes technology is making this possible. If there is a trade-off between complete disclosures and early disclosures, in the case of lenders without automated systems or where credit information is incomplete, HUD recommends that the time limits be sufficiently flexible to ensure that the consumer receives complete cost information, including settlement costs and rates and points. HUD also recommends that consumers receive initial disclosures before they pay a creditor a significant fee that might deter shopping.

B. Targeting abusive lending practices.

As part of any reform legislation, HUD and the Board recommend that additional substantive protections be adopted. These protections should target abusive lending practices without unduly interfering with the flow of credit and without narrowing consumer options in legitimate transactions. These protections should be included as part of any legislation, to ensure that all homeowners benefit from reform.

HUD and the Board recommend:

- **Protections** for borrowers in loans now subject to the Home Ownership Equity Protection Act (HOEPA) including--
 - **Further restrictions** on balloon payments,
 - **Prohibitions** against lump sum credit life insurance,
- **Federal rights** to notice in foreclosures advising consumers of their legal rights, the process to be followed if consumers do not exercise those rights, and information about the availability of third party counseling.

HUD also recommends **other key protections** including:

- **Counseling** - Requiring pre-transaction counseling where appropriate for vulnerable borrowers before they enter into HOEPA loans;
- **Reporting requirements** - Imposing reporting requirements on HOEPA loans for certain unregulated lenders;
- **Additional HOEPA Amendments** - Expanding coverage and protections under HOEPA, including such measures as regulating the financing of closing costs, requiring lenders to take into account the borrower's capacity to repay, expanding the current restrictions on prepayment penalties, and providing new protections for home improvement borrowers claiming contractor nonperformance or malfeasance;
- **New foreclosure prevention strategies** - Adopting new foreclosure prevention strategies that, where appropriate, include pre-foreclosure counseling and new Federal rights for borrowers to cure delinquent loans and recover remaining equity through private sale prior to foreclosure; and
- **A UDAP Standard** - Congress should consider establishing a new Federal unfair and deceptive acts and practices standard for transactions that are unfair or unconscionable.

HUD also recommends that

- **Additional Information** be provided to consumers under RESPA - that initial disclosures inform consumers of the functions of mortgage originators (including mortgage brokers), and that new requirements be established for escrow accounts and cancellation of private mortgage insurance (PMI); and that

- **Additional remedies** be established for misdisclosure and non-disclosure, private causes of action, expanded injunctive authorities, strengthened criminal sanctions, and more uniform statutes of limitations.

Moreover, in the event Congress does not enact major reform, HUD recommends that an essential reform package be enacted. This opportunity for reform should not be missed. The package would include: requirements for dissemination of educational materials earlier in the homebuying or mortgage shopping process; combining and simplifying the RESPA and TILA disclosures and coordinating their timing to the greatest extent feasible; disclosing the additional consumer information described above; requirements for more accurate estimates of settlement costs; simplified and new remedies against inaccurate disclosures and other consumer

protections; and appropriate protections against predatory lending.

Finally, HUD and the Federal Reserve agree that, for the public to benefit from the changes we propose, there must be a commitment to educating consumers about the changes. Consumers must understand the two disclosure approaches--guaranteed, and estimated settlement costs--and uses of the APR for purposes of shopping and negotiating loan terms.

Legislative reform under RESPA must provide more effective tools for consumer protection in today's marketplace--a marketplace radically different than the one that existed when RESPA and TILA were first written.

V. Conclusion

Madame Chairwoman and Mr. Chairman, on behalf of Secretary Cuomo, I want to thank you for the opportunity to appear here today to offer HUD's perspective on the joint report of the Board of Governors of the Federal Reserve System and HUD on RESPA/TILA reform. I am optimistic that our report can lead to reform that will enhance consumer protection, while simultaneously providing greater industry certainty and addressing other weaknesses in the current State and Federal coverage of mortgage loan transactions. To acquire a home, to enjoy a home, this is the bedrock of our liberty and our freedom in America.

I know that you both share these principles. Governor Gramlich, his colleagues at the Board of Governors and we at HUD are hopeful that these recommendations will move the debate on reform proposals. We stand ready to do whatever we can do to assist the Congress's efforts.